

**BEFORE THE ILLINOIS COMMERCE COMMISSION  
STATE OF ILLINOIS**

COMMONWEALTH EDISON COMPANY	)	
	)	<b><u>No. 10-0467</u></b>
Proposed general increase in electric rates	)	

**INITIAL BRIEF OF AARP**

February 10, 2011

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AARP<sup>1</sup> hereby submits arguments in this Initial Brief pursuant to the briefing schedule issued by the ALJ's order on January 26, 2011. AARP has limited its arguments in this brief to contested issues and has attempted to follow the agreed upon outline. AARP reserves the right to submit responses in its Reply Brief to any arguments made in the initial briefs of other parties. AARP also reserves the opportunity to present additional arguments on any issues set for oral argument by the Illinois Commerce Commission.

**I. Introduction / Statement of the Case**

Commonwealth Edison Company ("ComEd") bears the burden of proof in this docket to show that its current revenue requirement is insufficient to provide an opportunity to recover its reasonable electric distribution expenses and earn a fair rate of return. AARP believes when ComEd's testimony is viewed in the context of the

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<sup>1</sup> In 1999, the "American Association of Retired Persons" changed its name to simply "AARP", in recognition of the fact that people do not have to be retired to become members. AARP is a non-profit corporation that has been granted tax exempt status under Section 501(c)(4) of the Internal Revenue Code as a social welfare organization.

countervailing and compelling evidence submitted by the Illinois Attorney General's Office ("AG"), the Citizen Utility Board ("CUB"), and other consumer intervenors in this case, that it becomes clear that no revenue requirement increase is justified at this time. In fact, there exists competent and substantial evidence on the record proving a revenue requirement surplus.

## **II. Overall Revenue Requirement and Revenue Deficiency**

The combined expert recommendations of four witnesses sponsored by the AG and CUB show that ComEd's request for an increase in its current electric delivery service rates is not needed, and in fact, ComEd's existing rates should be decreased by approximately \$40,359,000. See AG/CUB Ex. 7.1, attached to the rebuttal testimony of Michael Brosch.

## **III. Ratemaking and the Need to Balance Shareholder and Ratepayer Interests**

AARP's primary interest in this case relates to how ComEd's proposed electric rate increase may impact its Illinois customers who are over 50 years of age. Older customers are particularly vulnerable to increases in energy prices, and they devote a higher percentage of their total spending than do other age groups on residential energy costs. Many such customers have been impacted particularly hard by the recent recession, and AARP hopes that the Commission takes that into account as it deliberates on how to carefully balance the interests of utility shareholders and utility ratepayers in this rate case.

It is generally undisputed that certain customers have been impacted harder than others by the lagging economy. AG witness Roger Colton provides the results of his research showing the impact that ComEd's proposed rate increase would have upon low-income electric customers. See Mr. Colton's Direct and Rebuttal testimony, AG Exhibits 5.0R and 9.0R. His description of the data regarding the financial circumstances of these vulnerable residential customers, and the disproportionate impact that a rate increase upon them, when the Commission is determining the public interest in this case.

ComEd rate of return witness Phillip O'Connor acknowledges that some individuals and some companies "have been hurt a lot more than others", while generally, "the utilities around the country are weathering the storm". Tr. 196. Mr. O'Connor believes that the weak economy should not be used as a "justification to ignore costs", but he does recognize that the Commission is free to take into account the impact that the economy has had on small and vulnerable customers when determining whether proposed electric rates are just and reasonable. Tr. 196.

## **V. Rate Base**

### **A. Overview**

Mr. Brosch testifies as to the importance of using a "test year" that balances all corresponding factors when regulating utilities, because it preserves a "matching" of revenues, expenses, cost of capital and rate base investments, in order to avoid overstating or understating the revenue requirement. AG/CUB Ex. 1.0, pp. 5-16. Mr. Brosch explains how ComEd's proposal to extend the test year in this case by an

additional 18 months to recognize growth in plant in service *without* recognizing the concurrent growth in accumulated depreciation and other offsetting elements of the revenue requirement would lead to an inflated rate base (overstating investments by as much as half a billion dollars). AARP urges the Commission to adhere to the matching principle in order to avoid overstating the amount of rate base upon which consumers must pay a return.

## **B. Potentially Contested Issues**

### **2. Construction Work In Progress**

Mr. Brosch recommends removing ComEd's Construction Work In Progress ("CWIP") from rate base because these investments are not yet in service for consumers, and thus not "used and useful" nor providing any benefit to consumers. AG/CUB Ex. 1.0, pp. 16-21; AG/CUB Ex. 7.0, pp. 26-28. Mr. Brosch explains how the more traditional approach could serve as an alternative to CWIP, providing a capitalized return in the form of an Allowance For Funds Used During Construction ("AFUDC"). Mr. Brosch further recommends that the Commission reject ComEd's proposal to place "short term CWIP" in its rate base because it is likely to have little or no actual cash investment requiring a return from customers. This issue involves a disallowance worth \$12,591,000. AG/CUB Ex. 7.1, Schedule B-7.

### **4. Cash Working Capital ("CWC")**

Mr. Brosch recommends that the Commission adopt a zero allowance for CWC. AG/CUB Ex. 7.0, pp. 11-25. Because ComEd's CWC analysis is based upon

assumptions that overstate its revenue collection so severely as to render its results useless, Mr. Brosch recommends a disallowance of \$89,703,000. AG/CUB Ex. 7.1, Schedule B-5.

## **7. Customer Deposits**

Customer deposits and advances represent a low-cost source of capital to the utility that are typically reduced from the rate base. AG/CUB Ex. 1.0, pp. 36-40. Mr. Brosch identifies serious problems with ComEd's calculations of customer deposits, such as ignoring continual growth, attributing the majority of deposits to an un-named jurisdiction, and failing to include any annual interest payments, and concludes that ComEd's rate base should be reduced by \$85,962,000. AG/CUB Ex. 7.1, Sch. B-8.

## **VI. Operating Expenses**

### **B. Potentially Contested Issues**

#### **1. Incentive Compensation Cost and Expenses**

AG/CUB witness Ralph Smith recommends that 50% of annual incentive plan ("AIP") compensation should be disallowed, resulting in an adjustment of \$12,060,000, because of a limiting provision in the AIP, and because the AIP payouts scheduled for February 2011 are to be paid out at 50%, rather than 100%, of target. AG/CUB Ex. 9.0, p. 9; AG/CUB Ex. 7.1, Schedule C-10.

Shareholders should bear the cost of the Executive Long-Term Incentive Compensation plan ("LTIP"), resulting in an adjustment of \$2,158,000. The LTIP is limited to executives, it is driven by financial and legislative goals, it contains a

subjective element to payouts, and is directly related to the interests of Exelon shareholders, as measured by Exelon total shareholder return and Exelon stock price appreciation. AG/CUB Ex. 9.0, p. 9-12; AG/CUB Ex. 7.1, Schedule C-10. Customers should not be compelled to serve as the source of such payments, which are not clearly designed to promote customer service.

## **VI. Rate of Return**

### **A. Overview**

The most competent and complete analysis of the issues inherent to setting a proper rate of return (“ROR”) in this case can be found in the testimony of AG/CUB witness Christopher Thomas. AG/CUB Exhibits 4.0 through 4.6; AG/CUB Ex. 10.0. The Commission must base its decision regarding a fair rate of return on the relative riskiness of the regulated company, based on the legal standards set forth by the U.S. Supreme Court governing this issue. AG/CUB Ex. 4.0, p. 16. ComEd’s rate of return proposals tend to be premised on the argument that, absent these proposals, ComEd will face unreasonable risk. Thus, ComEd is seeking to transfer risk from its investors to ComEd ratepayers through these issues. AARP urges that the Commission weigh the risks being proposed for transfer through ComEd’s allowed rate of return, in order to ensure that its ratepayers are not shouldering an unacceptably high level of risk. AARP also reminds the Commission that to the extent that any risk discussed is related to the overall sluggish economic climate, most ComEd customers are already bearing similar risks and have no recourse for transferring those risks to another party.

### **E. Cost of Common Equity**

Mr. Thomas' analysis concludes that the appropriate return on common equity ("ROE") for ComEd is 8.94%. AG/CUB Ex. 4.0, pp. 5-6. Current market conditions are leading investors to correctly perceive public utilities as less risky investments than other investments, and thus, ComEd's allowed ROE should be lowered accordingly. AG/CUB Ex. 4.0, pp. 7-16. Mr. Thomas notes how public utilities have no fear of losing customers when requesting increases in regulated rates or take advantage of risk-reducing cost recovery mechanisms (such as an uncollectibles rider, and power prices that are passed through to consumers on a separate rider). AG/CUB Ex. 4.0, pp. 14-15.

While ComEd's witnesses present two ROE analyses that have historically been rejected by the Commission (a risk premium and a comparable earnings test), Mr. Thomas used the two models that have been generally accepted by the Commission in the past—a Discounted Cash Flow ("DCF") model and the Capital Asset Pricing Model ("CAPM"). AG/CUB Ex. 4.0, p. 18. His non-constant growth DCF model calculated an ROE of 8.94%, and his CAPM generated a ROE of 6.69% - 9.05% (establishing the reasonableness of his DCF results). AG/CUB Ex. 4.0, pp. 19-29, 30-33.

Mr. Thomas also points out persuasively that the growth rates presented by ComEd witnesses are not sustainable when compared to its historic growth nor when compared to the overall U.S. Gross Domestic Product. AG/CUB Ex. 4.0, pp. 33-34. ComEd's ROE recommendations are 150 basis points above the ICC Staff recommendation and more than 100 basis points above any recently approved ROEs in Illinois. AG/CUB Ex. 4.0, pp. 10-11.



## **G. Overall Cost of Capital**

Using the agreed upon capital structure and debt cost information supplied by ComEd, and Mr. Thomas' recommended ROE, the appropriate overall rate of return for this electric company is 7.79%. AG/CUB Ex. 4.0, p. 37.

## **IX. Rate Design**

### **C. Potentially Contested Issues**

#### **1. SFV (ComEd Proposal)**

AG/CUB witness Scott Rubin asserts that ComEd's proposal that would drastically increase its customer charge while reducing distribution (per KWH) charges (so-called "straight fixed variable" rate design, or "SFV") bears no relationship to the reasons why various facilities are sized and installed on ComEd's system. AG/CUB Ex. 6.0, pp. 14-41; AG/CUB Ex. 11.0. Reputable utility economists reject the notion of pricing retail utility services based upon short-run costs—as SFV would do to ComEd's rate design. ComEd's proposal does not promote energy efficiency or social welfare and is unfair to residential customers. AG/CUB Ex. 6.0, pp. 14-21.

AARP further asserts that, to the extent that the proposed SFV rate design approach shifts more costs onto small usage customers, many individuals who live alone and families which aggressively limit their usage would be disproportionately harmed by a SFV rate design. As Staff points out, the SFV approach would also result in an inequality in the amount of fixed costs between small use and large use residential customers. Staff Ex. 13.0, pp. 16-26.

As an alternative to SFV, Mr. Rubin proposes a more reasonable residential rate design proposal for the minimum portion of the electric bill that each ComEd's customer is required to pay. Mr. Rubin proposes customer charges that vary depending on whether the customer is in a single-family (\$7.75) or multi-family building (\$5.96) and the same meter charge for all customers (\$2.60) which is based on his cost study. AG/CUB Ex. 6.0, pp. 42-47. AARP strongly opposes ComEd's SFV rate design, preferring the residential rate design approach to minimum charges laid out by AG/CUB witness Rubin's testimony.

## **2. Decoupling (NRDC Proposal)**

AARP is also opposed to the Natural Resources Defense Council's ("NRDC's") alternative rate design, which is an unreasonable version of "decoupling" presented by NRDC witnesses McDermott and Cavanaugh. NRDC Ex. 1.0 and 2.0. Professor McDermott acknowledges that there is a risk of variations in electric sales and usage that must be borne by the shareholders, the ratepayers, or both and that such risk cannot simply be made to disappear; however, he would not necessarily acknowledge that NRDC's decoupling proposal would shift that business risk to consumers. Tr. 1394-1396. AARP strongly disagrees, because although this proposed decoupling mechanism would not change the overall revenue requirement, it would allow electric rates to be raised higher for all residential customers, on a piecemeal per customer basis, as explained by the testimony of AG/CUB witnesses.

AG/CUB witness Brosch opposes NRDC's decoupling proposal, which he states has the effect of adjusting utility rates based solely upon changes in residential per-

customer sales volumes, without regard to other changes in the utility's rate base, operating expenses or cost of capital. AG/CUB Ex. 12.0. NRDC's plan ignores the fact that utility expenses, rate base, and cost of capital are dynamic and that decoupling does indeed shift business risks associated with changes in sales volumes from the utility to its customers. NRDC's request for baseline recovery on the allowed revenue requirement *per customer* represents single-issue ratemaking. NRDC's proposal is technically deficient as well, as it does not include a proposed tariff, contains no supportive analysis or documentation, and provides no evidence that the plan would lead to increased energy efficiency investments by ComEd. Id.

AG/CUB witness Rubin also responds to the NRDC decoupling proposal, and concludes that it would protect ComEd's revenue stream at the expense of consumers, with no indication that such an extreme measure would result in any increased investment in energy efficiency. AG/CUB Ex. 14.0, pp. 14-27. He points out that decoupling should be rejected because: (1) it is inconsistent with sound regulatory policies that have been developed over many decades; and (2) there is no evidence ComEd would increase its investment in energy efficiency programs if it decoupling was approved; and (3) there are better ways to promote energy efficiency investments. Id. AARP further notes that although NRDC's proposed per customer decoupling would attempt to decouple sales from the establishment of fair rates; it would fail to actually link rates to any existing or future energy efficiency goals.

While NRDC and ComEd argue that decoupling "removes a disincentive" related to the utility's desire to promote energy efficiency, the specific proposal under consideration does nothing to *create any additional incentive* towards conservation or

energy efficiency. Under NRDC's decoupling proposal, even those customers that aggressively conserve on electric usage would experience higher rates than traditional ratemaking would allow, robbing those customers of the full benefit of their conservation. Prof. McDermott admits that while such customers might experience a lower overall electric bill, it is possible that the energy savings experienced by those customers would be lessened by this proposal. Tr. 1405. The NRDC proposal would allow residential rates to be increased on a piecemeal basis across the board to all residential customers, including low-income customers; however, the so-called "removal of disincentive" to the utility would do nothing to provide assistance to low-income customers in financing energy efficiency investments. Tr. 1406.

There is another incentive that would be changed by the adoption of NRDC's decoupling proposal. By increasing the level of revenue that is likely to be collected by ComEd, decoupling would reduce regulatory lag on a single-issue basis. Prof. McDermott recognizes that a "properly designed regulatory program" can use regulatory lag to promote the cost effective operations of a utility. Tr. 1400. However, NRDC's *per customer* decoupling proposal would actually reduce regulatory lag, and thus weaken the incentive for cost efficiency. Prof. McDermott further admits that the NRDC proposal contains no component with an enforceable commitment to promote energy efficiency. Tr. 1403.

## **XII. Conclusion**

ComEd has not met its burden to prove that it is experiencing a revenue deficiency justifying an increase to its electric distribution rates. In fact, the test year

evidence in this case shows that just and reasonable rates for ComEd would justify a reduction in rates. Furthermore, the Commission should protect residential customers by rejecting both ComEd's proposed SFV rate design, as well as NRDC's decoupling proposal as unreasonable and harmful to ratepayers.

Respectfully submitted,

/s/ John B. Coffman

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John B. Coffman                      MBE #36591  
John B. Coffman, LLC  
871 Tuxedo Blvd.  
St. Louis, MO 63119-2044  
Ph: (573) 424-6779  
E-mail: [john@johncoffman.net](mailto:john@johncoffman.net)

Attorney for AARP

Dated: this 10th day of February, 2011.

### **CERTIFICATE OF SERVICE**

I, John Coffman, attorney for AARP, hereby certify that copies of the foregoing have been mailed first class postage prepaid, e-mailed or hand-delivered upon all active parties on this 10<sup>th</sup> day of February 2011.

/s/ John B. Coffman

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John B. Coffman